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IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

ITHACA INDUSTRIES, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

The Commissioner's brief in opposition presents no reasons why the Court should not grant the petition. The Commissioner attempts to avoid the merits by raising a spurious new issue, asserting that Petitioner has no basis in the acquired workforce, which is not correct. The Commissioner attempts to avoid the clearly controlling effect of *Newark Morning Ledger* by distinguishing it on the basis that the acquired workforce is not a "subscription" to a newspaper and with the assertion that a workforce is not a "revenue-generating asset." The Commissioner attempts to avoid the direct conflict between the opinion below and that of the Eleventh Circuit in *Citizens & Southern* on the basis that a workforce is not a "core deposit." Finally, the Commissioner argues that a new tax law which applies in future years limits the importance of this case, but ignores the confusing effect of

the opinion below upon the many taxpayers and pending cases not affected by the new law.

ARGUMENT

I. THE COMMISSIONER'S CONTENTION THAT ITHACA DID NOT ESTABLISH TAX BASIS IN THE ASSEMBLED WORKFORCE IS ERRONEOUS.

More than half of the Commissioner's brief is devoted to a non-issue—a contention that Ithaca has a zero basis in the assembled workforce since it "purchased" stock but failed to make an election to "step-up" the tax basis in the asset to the purchase price. This canard—raised for the first time on appeal—apparently is presented for purposes of obfuscation. The fact is, there was no purchase of stock. As the record clearly shows, the acquisition of the assembled workforce by Ithaca occurred as part of a "cash-out" merger. The merger documents and a description of the merger are stipulated and in the record. Jt. App. 25, R. 53-93, 781-783, 1021. For federal tax purposes a cash-out merger under state law is treated as a purchase of *assets* (not stock). *See West Shore Fuel, Inc. v. United States*, 598 F.2d 1236 (2d Cir. 1979) where the court stated:

> We agree with the court below and with the Commissioner that the transaction here, although carried out through the medium of a merger, in substance was a sale of assets coupled with a liquidation, not a direct sale of stock by shareholders to New American. We will assume, as taxpayers contend, that this transaction qualified . . . as a statutory merger and did not consist of a [actual] sale, exchange, or other disposition of assets [by the merged corporation]. We nevertheless conclude that as a matter of federal law, the transaction was a sale of assets, not a sale of stock.

598 F.2d 1236, 1242 (citations omitted). *See also* Rev. Rul. 69-6, 1969-1 C.B. 104. In such case, the tax basis

of the assets acquired is their cost. *See* Bittker & Eustice, *Federal Income Taxation of Corporations and Shareholders* (6th Ed.) ¶ 12.21[9]; Section 1012 of the Internal Revenue Code of 1986, as amended, 26 U.S.C. § 1012 (the "Code"). The record is clear as to this matter and it is not an issue in the case. If the case could be resolved against Ithaca on this basis, the Commissioner would have raised and pressed the issue in the trial court.

II. THE COMMISSIONER HAS UNSUCCESSFULLY TRIED TO DISTINGUISH THIS CASE FROM *NEWARK MORNING LEDGER* AND *CITIZENS & SOUTHERN.*

The Commissioner, like the court below, attempts to avoid the controlling effect of *Newark Morning Ledger Co. v. United States*, 113 S. Ct. 1670 (1993) on the basis that an "employee is not a subscription" to a newspaper. Petitioner will not dispute that observation. However, it is incorrect to assert that the rule of *Newark Morning Ledger* is limited in application to newspaper subscribers. That rule applies to *any* acquired intangible asset: if a taxpayer is able to prove the life of an acquired intangible asset with reasonable accuracy and its value, it can amortize the value over that life. Surely the Court did not grant certiorari in *Newark Morning Ledger* for the purpose of issuing a ruling that would clarify the confusion only for, and apply solely to, newspaper subscribers.

Remarkably, the Commissioner asserts that a workforce is not a revenue-generating asset, stating at p. 9 of the brief:

> [The assembled workforce] is, indeed, the exact opposite of a revenue-generating asset like a patent, copyright or long-term contract, or the "core deposits" of a bank. In particular, unlike "customer-based intangibles," factory and office workers do not represent the value of continuing patronage to petitioner (but, rather, continuing wage costs).

This *non*sequitur—that something cannot be a revenue-generating asset unless it is costless—would deny amortization and depreciation to every asset used in business since all revenue-generating assets have an attendant cost. Indeed, it is the revenue generated by the asset that justifies its cost, in this case, the wage cost, in the first place. Thus, the Commissioner's assertion that the assembled workforce is not a revenue-generating asset and consequently cannot be amortized is incorrect.

Furthermore, the Commissioner is incorrect in arguing that *Newark Morning Ledger* does not apply to the assembled workforce because it is not a "customer-based intangible," as was the asset in *Newark Morning Ledger*. This argument turns the historical concern with regard to amortization of intangibles on its head. The closer an asset gets to the customer, the more difficulty the courts have had with its amortization since "goodwill" is inherently customer-related. See *Newark Morning Ledger*, 113 S. Ct. 1670, 1676. In that case, the Court reviewed and discussed cases involving assets other than customer-based intangibles in developing its opinion, and it is not correct that the further an intangible asset gets from the customer the less it benefits from the holding in *Newark Morning Ledger*, which dealt with the most difficult of intangibles to consider.

The Commissioner attempts to avoid the direct conflict between the opinion below and that in *Citizens & Southern Corp. v. Commissioner*, 919 F.2d 1492 (11th Cir. 1990), *affirming* 91 T.C. 463 (1988), on the basis that a workforce is not a "core deposit" and with the repeated assertion that a workforce is not a revenue-generating asset. While it is true that this case does not involve core deposits, the conflict with *Citizens & Southern* cannot be avoided by that since the *rationale* of the two cases cannot be reconciled. And it is wrong to characterize a workforce as other than a revenue-generating asset. Thus, the conflict with *Citizens & Southern* remains apparent.

III. THE CONFUSION GENERATED BY THE OPINION BELOW IS NOT ELIMINATED BY THE NEW TAX LAW.

The Commissioner asserts that the Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13261 (g)(2), 107 Stat. 540, limits the importance of this case. But the Commissioner notes that the new law only applies to acquisitions of assets occurring on and after July 1, 1991. The acquisition of the assembled workforce by Ithaca occurred prior to that time, on August 28, 1983, and this case is not affected by the new law. Many other taxpayers have cases that are pending before various courts and the Internal Revenue Service that are not affected by the new law—and the Commissioner does not contend otherwise—so the confusion generated by the opinion below remains unabated. See, *e.g.*, the Brief *Amicus Curiae* on Behalf of Salomon Inc. in Support of Petitioner.

In *The Colony, Inc. v. Commissioner*, 357 U.S. 28, 78 S. Ct. 1033 (1958), the issue was whether assessments by the Commissioner were barred by the statute of limitations. Even though the rule had been clarified as to future years by a change in the law, the Court granted certiorari because of the importance of resolving the issue for years unaffected by the new law, stating:

> We granted certiorari because this decision conflicted with rulings in other Courts of Appeals on the same issue, and because the question as to the proper scope of § 275(c), although resolved for the future by § 6501(e)(1)(A) of the Internal Revenue Code of 1954, 26 U.S.C.A. § 6501(e)(1)(A), 78 S. Ct. 1037, 1038, *infra*, remains one of substantial importance in the administration of the income tax laws for earlier taxable years.

357 U.S. 31, 32, 78 S. Ct. 1033, 1035 (footnote omitted). Thus, as here, where the rulings of the Courts of Appeal are in conflict and application of the federal

tax laws remains uncertain for prior years affecting many taxpayers, the importance of this issue and of this case remains despite the adoption of a new tax rule to apply in future years. Federal tax laws have national impact and it is important that they be applied in a uniform manner.

CONCLUSION

The Commissioner has ineffectively attempted to distinguish *Newark Morning Ledger* on the ground that this case does not involve newspaper subscribers and to dodge the conflict with *Citizens & Southern* on the ground that this case does not involve core deposits. Despite those attempts, however, the irreconcilability with the opinions in *Newark Morning Ledger* and in *Citizens & Southern* is readily apparent. The Commissioner argues that a change in the tax law applying to future years limits the importance of this case, but fails to consider the effect of the opinion below on pending cases not subject to the new law. As in the case of *The Colony, Inc. v. Commissioner, supra*, the Court should grant the petition because the issue "remains one of substantial importance in the administration of the income tax laws for earlier taxable years."

Respectfully submitted,

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